

Message Text

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ACTION EB-07

INFO OCT-01 EUR-12 ISO-00 AGRE-00 CEA-01 CIAE-00 COME-00
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NSC-05 PA-01 AID-05 CIEP-01 SS-15 STR-04 ITC-01
USIA-06 PRS-01 SP-02 FEAE-00 OMB-01 XMB-02 OPIC-03
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-----181911Z 082704 /42

R 181802Z JAN 77
FM AMEMBASSY LONDON
TO SECSTATE WASHDC 9599
TREASURY DEPT WASHDC

C O N F I D E N T I A L SECTION 01 OF 03 LONDON 00900

PASS FEDERAL RESERVE BOARD, EXIMBANK; TREASURY FOR
MURRAY RYSS

E.O. 11652
TAGS: EFIN; UK, ETRD
SUBJECT: U.K. FOREIGN CURRENCY FINANCE

REFS: (A) LONDON 20283, 1976; (B) LONDON 20291, 1976;
(C) LONDON A-761, 1976; (D) LONDON 133

1. THE INTERNATIONAL FINANCE, TRADE AND AID BILL (REF E)
TAKES THE FIRST STEPS TO SHIFT U.K. TRADE FINANCE TO FOR-
EIGN CURRENCY FINANCE, A SHIFT DELINEATED IN THE DECEM-
BER 15 MINI-BUDGET (REF A, B). THE DETAILS OF THE EXPORT
CREDIT GUARANTEE'S (ECGD'S) PROGRAM TO EFFECT THIS SHIFT
ARE NOT YET COMPLETE, DUE TO A CONTINUING INTER-MINISTERI-
AL STRUGGLE OVER THE APPROPRIATE LEVEL OF U.K. EXPORT SUB-
SIDIES.

2. THE ECGD CLAIMS THAT IT IS A SELF-SUPPORTING INSTITU-
TION IN ITS ACTIVITIES AS A CREDIT INSUROR, AND SO CANNOT
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BE SUBSIDIZING EXPORTS ON THIS ACCOUNT. THE ANNUAL TRADE
REPORT IS PRESENTED TO SUPPORT THIS CLAIM.

COMMERCIAL	NATIONAL INTEREST
ACCOUNT	ACCOUNT
1974/75 1975/76	1974/75 1975/76
POUNDS	POUNDS
MILLIONS	MILLIONS

PREMIUM INCOME	36.8	42.9	15.7	16.7
INTEREST	14.8	18.8	9.6	10.7
	51.8	61.7	25.3	27.4

LESS:

PROVISION FOR NET BUYER

CLAIMS	12.4	28.5	1.8	4.1
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ADJUSTMENT TO PROVIS-

IONS FOR LOSS ON NON-

BUYER CLAIMS	0.1	1.2	1.5	0.4
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ADMINISTRATION EX-

PENSES	9.9	13.2	0.8	1.0
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	22.4	42.9	4.1	5.5
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ANTICIPATED OUT-TURN

FOR YEAR	29.2	18.8	21.1	21.9
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RESERVES BROUGHT FOR-

WARD	122.8	152.0	88.6	109.8
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RESERVE AT END OF YEAR	152.0	170.8	109.8	131.7
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THE ECGD TURNS ITS RESERVE OVER TO THE TREASURY'S CONSOLIDATED FUND, AND THE ENTRY "INTEREST" IS THE IMPUTED INTEREST ON THE RESERVE THAT THE ECGD CALCULATES IT HAS BUILT UP AT HMTREASURY OVER THE YEARS.

3. THE ECGD DEFENDS ITS COMMERCIAL ACCOUNT BUSINESS JUST AS IT DOES ITS COST ESCALATION INSURANCE: IF THE PREMIUMS ARE SUFFICIENT TO MAKE THE INSURANCE AT LEAST A FAIR BET FROM THE INSUROR'S POINT OF VIEW, THEN THERE IS A NET EXPECTED COST OF OBTAINING THE INSURANCE AND THE INSURANCE CANNOT BE A SUBSIDY. THIS ARGUMENT IS INSUFFICIENT, HOWEVER, ON AT LEAST TWO GROUNDS. FIRST IT BEGS THE ISSUE

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OF THE COSTS THAT ARISE FROM TRANSFERRING RISK (AS DISTINCT FROM EXPECTED RETURN) FROM THE PRIVATE TO THE PUBLIC SECTOR. SECOND. IT IS NOT PROPER TO LOOK AT EXPORT CREDIT INSURANCE OPERATIONS IN ISOLATION BECAUSE A BANK ADVANCE MUST FIRST RECEIVE SUCH INSURANCE BEFORE ECGD WILL

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C O N F I D E N T I A L SECTION 02 OF 03 LONDON 00900

PAY AN ADMITTED INTEREST SUBSIDY ON THE LOAN.

3. THE ECGD REFINANCES THE GUARANTEED ADVANCES OF THE CLEARING BANKS, AND SUPPLEMENTS THE CLEARING BANKS' INTEREST RECEIPTS ON THOSE COVERED ADVANCES IT DOES NOT REFINANCE (REC C). THE BANKS MUST REFINANCE ALL THEIR ADVANCES BEYOND A CERTAIN PERCENT (CURRENTLY 18 PERCENT, BUT SOON TO BE GREATER THAN 21 PERCENT) OF THEIR CURRENT BALANCES. THE INTEREST RATE SUPPLEMENT IS CALCULATED USING TWO INTEREST RATES, THE FIXED RATE WHICH IS THAT CHARGED TO TRADERS. AND AN AGREED INTEREST RATE THAT IS CALCULATED WITH REFERENCE TO MARKET RATES OF INTEREST. THE ECGD PAYS THE CLEARING BANKS THE DIFFERENCE BETWEEN THE LEVEL OF INTEREST THAT TRADERS IN FACT PAY AND WHAT WOULD BE PAID AT THE AGREED RATE OF INTEREST ON THE UNREFINANCED PART OF THEIR TRADE ADVANCES. THE ECGD'S TRADING RESULTS ACCOUNT FOR THE INTEREST RATE SUPPLEMENT AS FOLLOWS:

FIXED RATE EXPORT ADVANCES REFINANCED BY ECGD AND INTEREST RATE SUPPLEMENT (POUNDS MILLIONS)
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FINANCIAL YEAR	NET INCREASE IN QUARANTEED FIXED RATE EXPORT ADVANCES	NET INCREASE IN THE BANKS	ANNUAL REFINANCING LOANS COST MADE BY ECGD TO THE BANKS	OF INTEREST SUPPLEMENT
1972/73	271	224	20	
1973/74	250	188	95	
1974/75	437	382	137	
1975/76	660	455	140	

THE ENTRY "ANNUAL COST OF THE INTEREST RATE SUBSIDY," RE-

FERS TO THE DIFFERENCE BETWEEN THE AMOUNT THAT ECGD PAYS TO THE CLEARING BANKS ON THE UNREFINANCED ADVANCES, AND THE INTEREST ECGD RECEIVES ON THE REFINANCED ADVANCES. HMTREASURY SOURCES NOTE THAT IN HOUSE THEY ESTIMATE AN ADDITIONAL OPPORTUNITY COST OF AROUND 150 MILLION POUNDS PER YEAR ATTRIBUTABLE TO THE HIGH COST OF HMT BORROWING RELATIVE TO THE FIXED RATE OF INTEREST RECEIVED.

4. THE FIXED RATE OF INTEREST IS LOW RELATIVE TO U.K. MARKET RATES BUT SATISFIES THE GENTLEMEN'S AGREEMENT AS IT STANDS. U.K. INTEREST RATES ARE, HOWEVER, ONLY HIGH IN SOME ABSOLUTE NUMERICAL SENSE. IF THEY ARE TRANSLATED INTO DOLLAR INTEREST RATES BY ADJUSTING FOR THE COST OF FORWARD COVER (OR LAST YEAR BY THE RATE OF DEPRECIATION OF STERLING) THEY ARE LOWER THAN DOLLAR RATES. A FIXED RATE OF 8 PERCENT WOULD, IN 1976, HAVE CORRESPONDED TO APPROXIMATELY A MINUS TWO PERCENT RATE OF INTEREST SO TRANSLATED. EXPORTERS HAVE FURTHERMORE IMPRESSED UPON THE ECGD THE VALUE OF FIXED RATE STERLING FINANCE IN SELLING THEIR WARES.

5. HMTREASURY HAS URGED THE ADOPTION OF FOREIGN CURRENCY FINANCE AS A MEANS OF REDUCING ITS SUBSIDY TO U.K. EXPORTS. IT HAS FURTHER NOTED THAT IN A FLEXIBLE EXCHANGE

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RATE SYSTEM FOREIGN CURRENCY FINANCE AND COST ESCALATION MUST BE CONSIDERED JOINTLY (REF D). THE ECGD AND THE U.K. EXPORTERS HAVE RESISTED THE MOVE AS UNWARRANTED GENERALLY, AND BADLY TIMED IN PARTICULAR IN LIGHT OF U.K. EXPORT RE-

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QUIREMENTSTO ACHIEVE WHAT MEAGER ECONOMIC GROWTH IS FORE-
CAST FOR 1977. THE ECGD HAS ATTEMPTED IN THIS VEIN TO
HOLD DOWN THE NUMBER OF CASES WHERE IT COULD ONLY PROFFER
FOREIGN EXCHANGE FINANCE. FOR EXAMPLE, ECGD WOULD PREFER
TO LIMIT FOREIGN EXCHANGE FINANCING TO ITS NATIONAL INTER-
EST BUSINESS, THAT IS BUSINESS THAT IT ACCEPTS ONLY AT
THE BEHEST OF THE GOVERNMENT RATHER THAN OUT OF ITS COM-
MERCIAL EVALUATION. AS A PRACTICAL MATTER, NATIONAL IN-
TEREST BUSINESS ARISES FROM EXCESS EXPOSURE IN A PARTICU-
LAR MARKET. THE ECGD SETS LIMITS ON THE LEVEL OF ADVANCES
IT WILL GUARANTEE TO ANY MARKET, FOR EXAMPLE, THE SOVIET
UNION'S LIMIT IS 100 MILLION POUNDS WITH MATURITIES LESS
THAN 12 YEARS, AND ANY ADVANCES BEYOND THESE LIMITS WILL
BE GUARANTEED AS A LOAN IN THE NATIONAL INTEREST.

6. SOURCES INDICATE THAT THE PROGRAM MIGHT REQUIRE ALL
LARGE CONTRACTS, AS WELL AS TRADE IN TRADITIONAL DOLLAR
AREAS AS IN THE WESTERN HEMISPHERE, TO BE FINANCED IN FOR-
EIGN CURRENCY. THE SOURCES FOR ECGD'S DIRECT LOANS HAVE
NOT BEEN DETERMINED, BUT EURO CURRENCY BOND ISSUES BY EITH-
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ER THE BANK OF ENGLAND OR THE ECGD ITSELF HAVE BEEN DIS-
CUSSED.

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Message Attributes

Automatic Decaptioning: X
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Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
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SAS ID: 3573675
Secure: OPEN
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Subject: U.K. FOREIGN CURRENCY FINANCE
TAGS: EFIN, ETRD, UK
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